

Hexcel Corporation

Annual Report 2003

transformation



Financial Highlights

	2003	2002	2001
Net Sales	\$ 896.9	\$ 850.8	\$1,009.4
Gross Margin	19.5%	19.0%	18.9%
Operating Income	\$ 57.8	\$ 60.2	\$ (316.2)
Interest Expense, net	\$ 53.6	\$ 62.8	\$ 64.8
Net Loss	\$ (11.1)	\$ (13.6)	\$ (433.7)
Diluted loss per common share	\$ (0.54)	\$ (0.35)	\$ (11.54)
Debt, net of Cash	\$ 441.7	\$ 613.5	\$ 674.3
Total Assets	\$ 722.7	\$ 708.1	\$ 789.4

About Hexcel

Hexcel is a leading international producer of composite materials, reinforcements and structures serving commercial aerospace, space and defense, electronics and various industrial markets.

The Company is a leader in the production of honeycombs, prepregs and other fiber reinforced matrix systems, woven and specialty reinforcements, carbon fibers and aircraft structures. Hexcel materials are used in thousands of products, making everyday life easier and safer for millions of people around the world. The lightweight, tailorable nature of our materials has helped transform numerous industries over the past 55 years by making products lighter, stronger and faster. We are the strength within many of today's lightweight, high-performance products.

To Our Shareholders

Compared to the turbulence of the prior two years, Hexcel's 2003 appears on the surface to have been uneventful. Year over year, sales were virtually flat and earnings up only modestly once adjusted for currency and restructuring impacts. But, in fact, history may well define 2003 as a pivotal year in many ways for both our company and the markets we serve.



David E. Berges
Chairman, CEO and
President

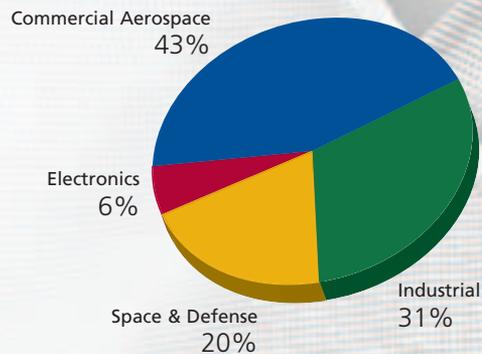
Internally, we largely completed a transformation of Hexcel that was begun after that fateful September 11th. We initially focused on "right-sizing" our operations for the dual shocks to electronics and commercial aerospace in 2001, then "right-shaping" our capital structure to align with short term market realities. In our end markets, thanks to the work done by many people both in and outside Hexcel over the past few years, the pace of migration to advanced structural materials accelerated in 2003. From recreation to wind turbines to commercial aerospace, composite materials are moving from niche to mainstream.

We chose **Transformation** as the theme of this year's annual report because in 2003, we transformed our organization, transformed our balance sheet, and our customers are transforming their approach to materials for their products.

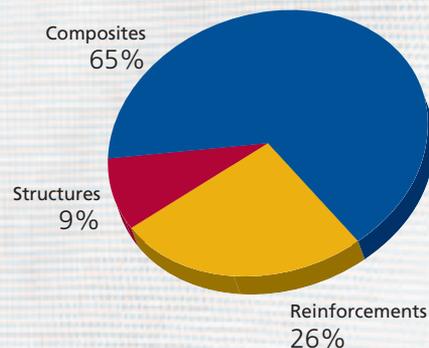


Hexcel is the exclusive supplier of carbon fibers and a major contributor of composite materials for the F-18 E/F, the U.S. Navy's latest Strike Fighter.

2003 Sales by Market



2003 Sales by Business Sector



2003 Results

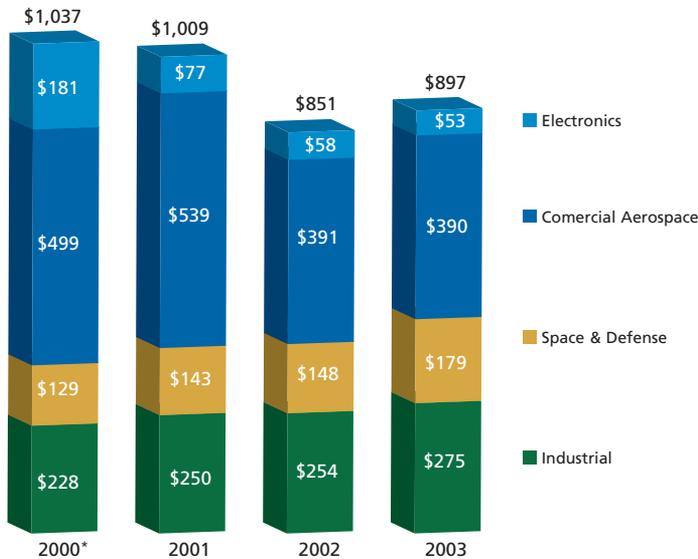
First, let's do the numbers. Our sales for 2003 reached \$896.9 million, up over 5% from the prior year, but most of the apparent growth was actually due to the strength of European currencies. On a constant currency basis, revenues were up less than 1%. Not surprisingly, our Space and Defense market was our growth leader, up over 21% due to a wide range of programs in both the U.S. and Europe. Our Industrial market sales came in strong as well, up 8%, driven by demand for our ballistics fabrics used extensively in protective vests for the U.S. military. We are proud to be

playing a role in saving lives during these violent times. The continued penetration of composite materials in recreation, wind, auto and marine applications also contribute to our favorable Industrial market trends. These two markets combined have grown 27% since 2000, helping to offset the trauma of our other markets. Sales of glass reinforcements for printed wiring boards make up our Electronics market and had another difficult year, now representing only 6% of our sales. Finally, Commercial Aerospace, our biggest market segment was flat at \$390 million, but down almost 28% from its peak in 2001. We are encouraged that electronics and commercial aerospace demand seems to have bottomed and the worst may be behind us.

A more detailed discussion of earnings is included in the latter section of this report, but in summary, we made progress on almost every measure if you adjust for business consolidation and restructuring costs and their associated depreciation impacts. After correcting for currency shifts, we held cash fixed costs despite the significant increases in audit fees, insurance and legal expenses that most U.S. public companies experienced. Cash management initiatives allowed us to continue our progress on debt reduction as we reached a 5 year low in net debt. Solid progress with little help from real-top line growth.

But 2003 is more a story about **transformation...**

Revenues by End Market
(In millions of U.S. dollars)



*Pro-forma for the sale of the Bellingham Interiors business as if the sale had occurred on Jan. 1, 2000.



Organizational Transformation

In addition to improved financial performance, progress was made on many other fronts. We had dramatic improvements in key operational metrics such as safety, on-time delivery, and quality. Important new products were developed and a massive effort to support Airbus A380 qualifications was expended – all with an organization a third smaller than in 2001, when market factors forced us to rethink our entire organizational size and structure. The accomplishments of 2003 demonstrated that we have succeeded in what can best be described as a transformation.

The need for transformation began in the second quarter of 2001, as the “dot-com” bubble burst, leaving a massive world-wide electronics infrastructure surplus, as well as stranded inventories throughout the supply chain. Hexcel’s sales to this market dropped by two thirds, almost overnight. It had been our second biggest market segment – the first was commercial aerospace. The senseless tragedy of September 11th made the dot-com bust seem a distant memory, even though it followed by just a quarter. Two markets representing over 65% of Hexcel’s sales shocked like never before, *in a matter of months!*

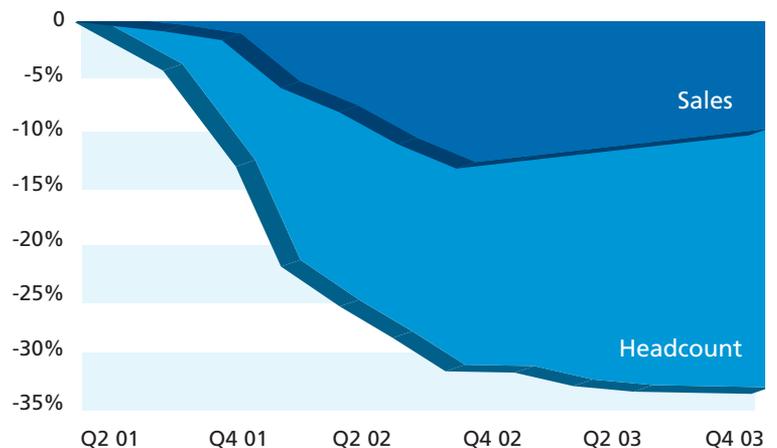
With no near-term prospects for recovery, the strategic plans developed to deal with rapid growth were useless. We had to become a smaller company...quickly. In the months that followed, we cut inventories, capital spending, plants, management layers and overhead. What had been called “fixed costs” were attacked the hardest, cut by 23% in 2002 from the prior year, though total Hexcel sales declined by only 15%. The transformation continued into 2003 and since the second quarter of 2001, total employment has now been reduced by over 34%. These weren’t arbitrary, across-the-board cuts. The plan was to

become a smaller company, properly organized for the near-term market outlook. The cuts were heaviest around infrastructure; 50% of senior executive and 40% of the corporate staff positions were eliminated.

Transforming the company for the future wasn’t just about cuts. The best and brightest were given expanded roles or moved into new positions. Markets and products with growth prospects received new focus and resources. Wage increases and bonus programs remained in place to motivate those who would be taking us forward. Throughout 2003, this new, lean organization has developed into a more potent team than before the trauma of 2001. We are better positioned to respond to opportunity and are committed to keeping the small company feel so we can get leverage from the growth to come. The term “right-sized” is surely overused, often abused, but Hexcel has the numbers to support such a claim.

→ *Organizational transformation complete.*

Changes in Sales & Headcount Levels



Global Hawk and NH 90 – Air frames of military air and rotorcraft are built with a higher proportion of composites in each succeeding generation.

equity raised + debt level reduced + maturities extended = capital structure right-sized

Capital Structure Transformation

The acquisitions of the 90's positioned Hexcel as a world leader in advanced structural materials. They also created a lot of debt – too much for the post 2001 environment. Despite the cost cuts, interest expenses were consuming all operating earnings – and then some. More importantly, significant debt maturities were coming due before a market recovery could be expected. Armed with a revised business plan that made sense in even the darkest of markets, 2003 was the time to address our capital structure. Our performance in the eighteen months following the tectonic shifts of our biggest market segments gave us the confidence to approach both the equity and debt markets.

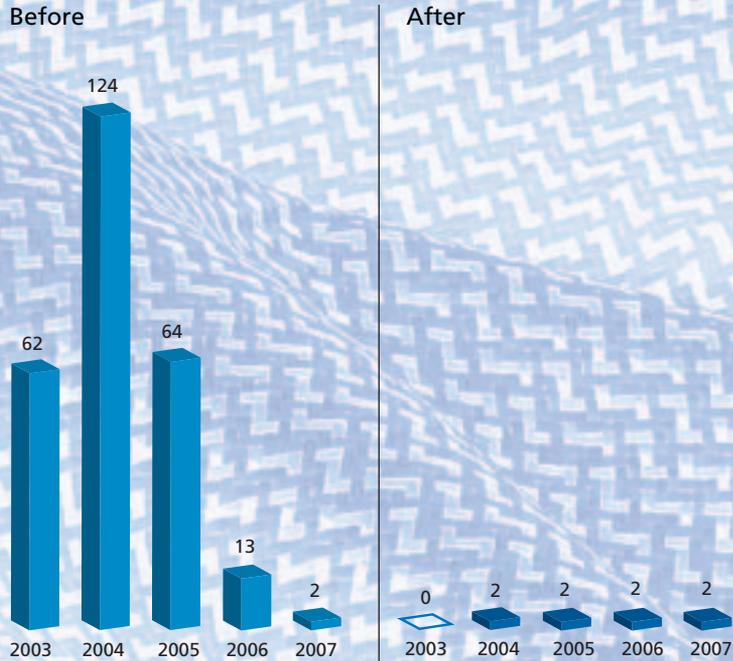
Despite the fears of SARS, the threat of terrorism and the impending war, we were able to issue new equity for \$125 million in cash, raise \$125 million through a new issue of senior-secured notes and establish a new \$115 million senior secured credit facility. All three transactions were closed simultaneously on March 19th, 2003, the day the war in Iraq began. Later in the year, we sold our minority position in a Japanese electronics joint venture and bought out a \$25.6 million capital lease obligation.

These actions, combined with the generation of over \$31 million from operations (net of capital expenditures & dividend receipts) in 2003 allowed us to reduce our net debt to \$442 million, the lowest it's been since 1998, down 35% from the summer of 2001, when our difficulties began. Our total leverage is now down to a level more appropriate for the bottom of the aerospace cycle and our interest expense is greatly reduced. Most importantly, we have no major debt maturities until 2008. Prior to these actions, we had \$265 million of debt due through 2007; now we have less than \$8 million in the same period. If our organizational restructuring result can be labeled "right-sized," we can now claim to be "right-shaped" as well.

→ *Capital structure transformation complete.*

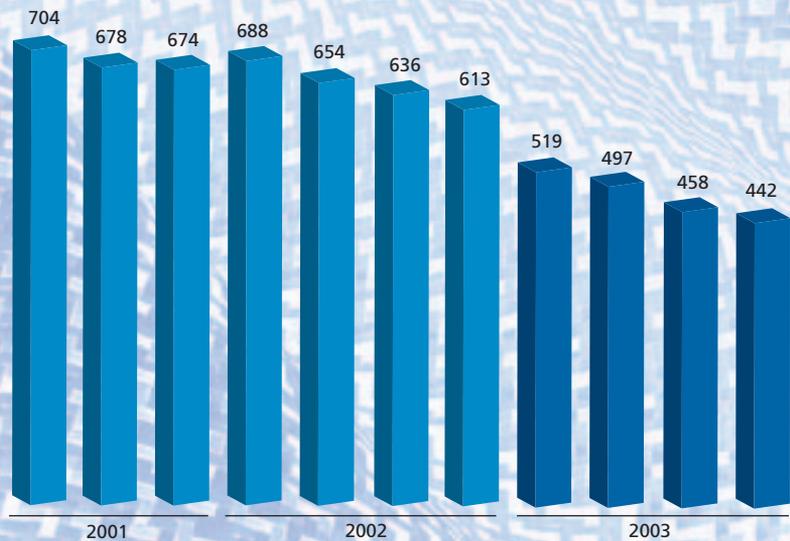
Refinancing Impact on Maturity Schedule

(in millions of U.S. dollars)



Debt Management

(debt net of cash in millions of U.S. dollars)



By quarter, beginning Q2 2001

Market transformation

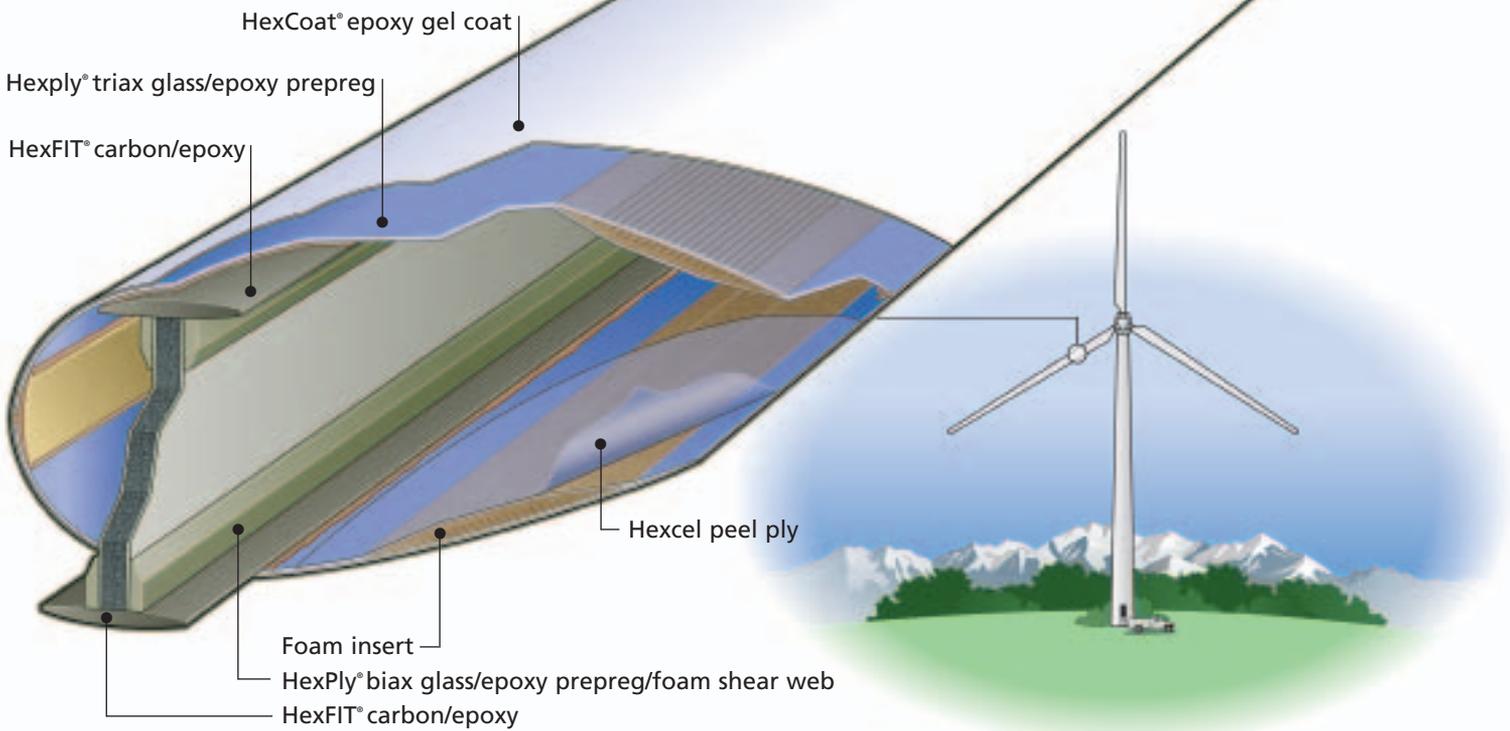
While the recovery of the economic cycle seems well on the way, and we expect continued growth in our Industrial and Space and Defense markets, it is too soon to declare our Electronics and Commercial Aerospace markets cured. How the Electronics market will evolve remains unclear. Commercial Aerospace at long last is starting to see improved passenger traffic, especially in Asia, but the finances of the airlines and price per ticket are still well behind levels that will return the sector to a firm growth path.

However, a transformation is underway in another way: the penetration of advanced structural materials into a wide range of markets and applications. **Wood to metal to composites** – the transformation of performance products

seems relentless, even accelerating. Fishing rods, arrows, skis, boats, golf shafts – each has gone through a similar transformation when premium performance is sought. Low-cost but functional wood, displaced by higher cost but more durable metals, then moving to more tailorable and corrosion resistant glass fiber composites and/or even higher performing carbon fiber reinforced composites.

Tennis racquets were made of wood for years, then moved to metal in the 1970's to provide a more consistent product that didn't warp. Carbon fiber composite structures were introduced as a high-end niche for professionals in the early 1980's but now account for almost 60% of world wide sales of racquets for Head.





Hexcel offers a wide range of products to wind turbine manufacturers

Hockey sticks have been made of wood since the first organized indoor games back in 1875. Metal shafts with replaceable wooden blades were introduced in 1981. But in 2003, carbon fiber composite hockey sticks were used by over 80% of the players in the NHL. The flex, like a golf shaft, can be custom tailored for the player and a wrist shot can now travel up to 20% faster off a carbon stick. Sales of these sticks represented about 85% of our customer, Easton Sports' stick and blade sales last year.

Wind energy depended on wooden blades since before the time of Don Quixote. As the blades and output grew in size and volume, metal took the place of wood, followed by glass composite materials. With installed capacity of renewable, environmentally friendly wind energy growing at 30% per year since 1996, wind turbine manufacturers are designing larger and larger blades (some approaching 150 feet in length) to generate more power per installation. As blades grow, their weight increases by more than the cube of the length, leading a number of manufactures to turn to carbon reinforced spars, the load bearing strut inside a blade. The same stiffness and light weight of carbon that solved the most

difficult performance problems of military aircraft is now going mainstream in wind turbines.

Wood to metal to composites – the same is true for aerospace. Just over 100 years ago, in December 1903, the Wright brothers flew for the first time. The core structure for aircraft was wood until the "all metal" Ford Tri-Star flew 30 years later. Metal transformed the industry and was the material of choice for the vast majority of aircraft structures until a couple of top-secret stealth aircraft were designed by the military in the early to mid – 1980's. Major airframe components, including the wing and fuselage, for the first time in production aircraft programs, were made of carbon fiber composites, much of it from a 30 year young Hexcel Corporation. The composite transformation for military aircraft had begun and today, every major military fighter aircraft in the U.S. and Europe is made of advanced structural materials such as Hexcel honeycomb core, carbon fiber and prepregs. The move from wood to metal, and later metal to composites, in military aircraft was transformational – a step change. Once the benefits of new materials are understood and proven, there's rarely a turn back.

After 1,000,000 cycles, some aluminums lose half their strength,
carbon fiber composites lose less than 10%

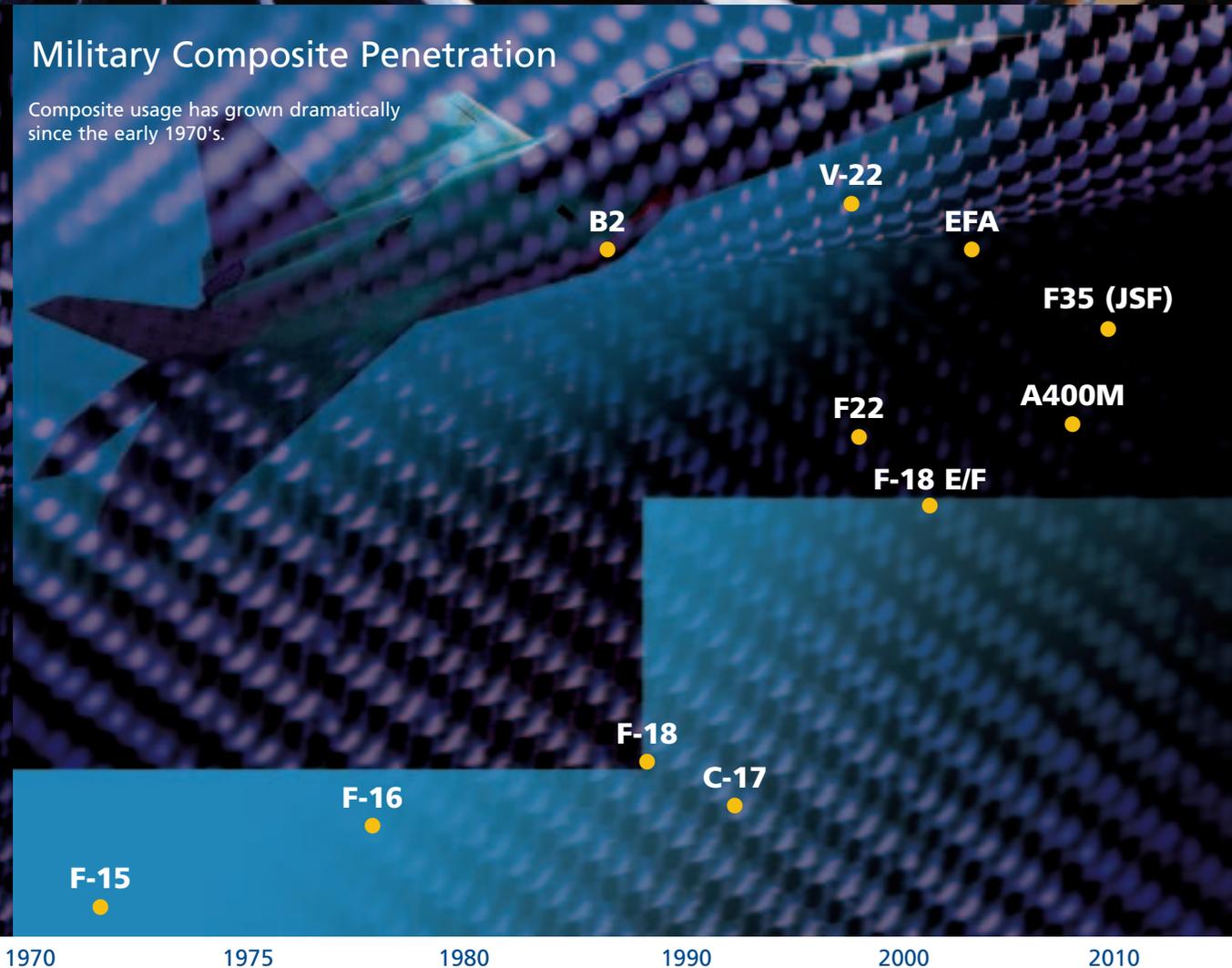
An ingenious composite front fan made exclusively from Hexcel carbon fiber and prepreg helps the GE90-115B produce more thrust and less noise than other engines on the market today.

Military Composite Penetration

Composite usage has grown dramatically since the early 1970's.

High

Low



Commercial Composite Penetration

High

Commercial aircraft are now following the military's transformation to composites.

7E7



Low

At long last, the same change seems underway in commercial aerospace, Hexcel's biggest market. For years, conservative aircraft designers have been slowly introducing composites. Piece by piece, they've developed data and confidence on the benefits of carbon fiber reinforcements. In addition to lightweight, stiffness and corrosion resistance, carbon fiber composites offer significantly extended life. Repeated flexing of metals during flight, particularly in the aerodynamic loading of wings and the repeated pressurization cycles of a fuselage, lead to the ultimate weakening of the structure from fatigue. After 1,000,000 cycles, some aluminum components lose half their strength – carbon fiber composites designs can lose less than 10%.

Every new commercial airplane design has more composite material than the one it replaces. The new Airbus super jumbo A380 now being built for 2006 service is more than 22% composites by weight, but it still has metal wings and fuselage. Next on the design table at Airbus is the A-400M, a large military transport that will have carbon fiber composite wings moving the composite content beyond 30%. And in 2003, Boeing announced that their next airplane, the 7E7,

will have a composite fuselage and wings bringing the composite content to over 50% of its weight.

New airplanes take a long time to develop and launch. The 7E7 is not planned to enter service until 2008 or later. But the move from metals to carbon fiber reinforced composites in large transport aircraft is in the midst of a step change. A change that will transform the opportunity for advanced materials. The long term growth potential for Hexcel has always been clear, in 2003, that prospect became even more promising.

If the "Graduate" was filmed today, "Composites" would have been the word whispered into Dustin Hoffman's ear.

→ **Wood to metal to composites** – a transformation **underway**.

After September 11th, 2001, my forty-third day as a Hexcel employee, many told me I was in the wrong place at the wrong time. I never thought that way. Today, Hexcel is right-sized, right-shaped, and right-placed. With only right-time left to go, I'm glad I'm a shareholder – I hope you are too.

David E. Berges, Chairman, CEO and President

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David E. Berges
Chairman of the Board, Chief
Executive Officer and President
Hexcel Corporation

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Martin L. Solomon
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Finance Committee
Nominating/ Governance Committee

*Denotes Committee Chair

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David R. Tanonis
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Hexcel common stock is listed on the
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